

TRADING FRICTIONS AND CONSUMPTION-OUTPUT COMOVEMENT

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ABSTRACT

The tradable sector has a lower consumption-output comovement than that in the nontradable sector. An artificial autarky generates identical comovements. Once the economy is open, however, the comovement in the nontradable sector becomes too low. The paper demonstrates that the intensity of labor adjustment across sectors is the main reason for the above results. In autarky model, investment adjustment is limited, so is labor and output; with free trade, investment and hence labor adjust to a greater size and output moves opposite to consumption in the nontradable sector. Therefore, a model with trading frictions can account for the data. (C) 2014 Elsevier Inc. All rights reserved.

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